February 22, 1996

DOCKET NO. E-017/M-95-1454

ORDER APPROVING RIDER, APPROVING ELECTRIC SERVICE AGREEMENT, AND APPROVING PROPERTY TRANSFER

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Joel Jacobs	Chair
Tom Burton	Commissioner
Marshall Johnson	Commissioner
Dee Knaak	Commissioner
Don Storm	Commissioner

In the Matter of a Petition by Otter Tail Power Company for Approval of a Rider to its Large General Service Time-of-Use Tariff, a New Electric Service Agreement with Lakehead Pipe Line Company, and Transfer of Property

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PROCEDURAL HISTORY

On December 29,1995 Otter Tail Power Company (Otter Tail or the Company) filed a petition seeking Commission approval of three Company initiatives:

> (1) a rider to its Large General Service Time-of-Use tariff, reducing rates to large industrial customers willing and able to take service under specified conditions at transmission voltage;
>
> (2) the sale of an electric substation to Lakehead Pipe Line Company (Lakehead), its largest customer, to make it possible for Lakehead to take service at transmission voltage and qualify for service under the rider;[1] and
>
> (3) an electric service agreement with Lakehead executed under the rider;

On January 18, 1996 the Department of Public Service (the Department) filed comments. The Department supported the Company's proposals, subject to three conditions:

> (1) demand reductions attributable to conservation, which reduce firm demand under the rider, must be verified in the Conservation Improvement Program (CIP) process;
>
> (2) customers must sign five-year contracts to qualify for service under the rider; and

[1]The Company planned to sell six substations to Lakehead, but believed only one of the sales required Commission approval under Minn. Stat. § 216B.50.

(3) all six substation sales must be approved by the Commission under Minn. Stat. § 216B.50.

On January 26, 1996 the Company filed reply comments. The Company accepted the Department's recommendation that demand reductions be verified in the CIP process. It questioned the advisability of requiring five year contract terms, fearing that would inhibit use of the rider. Finally, it requested Commission approval of all six substation sales, should the Commission find all six sales subject to Minn. Stat. § 216B.50. It also filed the information necessary for the Commission to act on all six sales.

The matter came before the Commission on February 8, 1996. At that point the Department withdrew its recommendation to require five-year contracts under the rider.

FINDINGS AND CONCLUSIONS

For the reasons set forth below, the Commission agrees with the parties that the tariff rider, electric service agreement, and property transfer are in the public interest and should be approved.

I. Tariff Rider

A. Company's Proposal

The proposed tariff rider permits qualifying customers to increase their permanent demand above historical levels without incurring ratchet penalties. Eligibility is limited to customers who take service at transmission voltage and have demand levels of at least 10 megawatts. The 10 megawatts can be metered or can be the coincident total demand at multiple, non-contiguous facilities functioning in a series.

The utility and the customer agree on baseline demand levels, which apply for the duration of the electric service agreement. Usage above these levels is billed at system marginal price -- hourly system incremental fuel and maintenance costs -- plus an adder of at least five and no more than ten mills. Customers are required to curtail usage to baseline demand levels upon notice from the utility; failure to curtail carries financial penalties.

B. Commission Action

The proposed rider is similar to those approved for the large customer classes of other utilities. These riders have been developed to meet the unique challenges large customers pose to local distribution companies.

On the one hand, large customers' high consumption levels make them valuable to the utility and other ratepayers; their large contributions to fixed costs can help stabilize and moderate rates. On the other hand, these customers are highly price-sensitive and have alternative energy options, exposing utilities and ratepayers to the risks of rate shock and stranded investment, should they leave the system. Long term contracts, linking reduced rates with long term commitments, have been major tools for keeping large customers on the system.

The proposed rider is just, reasonable, and consistent with the public interest. It benefits all parties -- the customer, by providing rate relief; the utility, by ensuring a dependable revenue stream; other ratepayers, by guaranteeing significant, long term contributions to fixed system costs. The rider will be approved.

The Commission agrees with the parties that a mandatory five-year contract term is unnecessary. The Company has adequate incentive to negotiate the longest contract term possible, and imposing a five-year minimum could preclude some advantageous contracts.

II. Property Transfer

A. Company's Proposal

The Company proposes to sell Lakehead six electrical substations[2] and their associated equipment. Each substation serves one of Lakehead's pumping stations. Acquiring the substations would allow Lakehead to take service at transmission voltage and quality for service under the proposed rider.

Originally the Company requested Commission approval for only one substation, the Cass Lake substation, because it was the only one being sold for more than $100,000. The statute governing utility property transfers, Minn. Stat. § 216B.50, provides as follows:

> No public utility shall sell, acquire, lease, or rent any plant as an operating unit or system in this state for a total consideration in excess of $100,000, or merge or consolidate with another public utility operating in this state, without first being authorized to do so by the commission. . . .

When the Department claimed all six sales related to a single operating system, the Company demurred, but filed the information necessary to evaluate all six sales, should the Commission agree with the Department.

The Company asks the Commission to approve the sales as of January 1, 1996, to spare the parties the inconvenience of recalculating the purchase price to reflect subsequent depreciation and to allow Lakehead to qualify for the transmission rates on file as of that date.

B. Commission Action

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[2]Those substations are Viking North, Donaldson, Plummer, Cass Lake, Cass Lake North, and Clearbrook.

The Commission agrees with the Department that the six substations are being purchased as an operating system, to allow Lakehead to take service at transmission voltage, and should be viewed as an operating system under Minn. Stat. § 216B.50. Only when their usage is combined do all six pumping stations qualify for service under the rider. Treating the pumping stations as a system for rate purposes, and the substations serving them as discrete units for property transfer purposes, would be anomalous. Viewing the sales in this light, the Commission finds them to be in the public interest and will approve them.

The sales price, original cost less depreciation, is the classic measure of the value of utility property; it is fair and reasonable. The effects of the property transfer on ratepayers are all positive. The substations are used exclusively to provide service to Lakehead pumping stations. Once sold, they will not have to be replaced, or for that matter, maintained. Rates will ultimately reflect lower costs due to savings on maintenance and depreciation, as well as removal of the substations from rate base. Since the substations are dedicated to the service of just one customer, the one buying them, losing them will not compromise system safety or reliability.

Finally, the Commission will approve the sales as of the date specified in the contract, to spare the parties the administrative burden of recalculating the contract price and to expedite Lakehead's eligibility for the transmission rates on file on that date.

III. Electric Service Agreement

A. Company's Proposal

The proposed electric service agreement between the Company and Lakehead combines the usage of all Lakehead pumping stations for purposes of meeting the 10 megawatt usage threshold. The agreement establishes a baseline demand level of 48 megawatts.

Either party may reduce baseline demand levels by up to five megawatts in the years 1999 and 2000. Two years' notice is required, and the other party may extend the contract by two megawatt months for each megawatt month's reduction. Lakehead may reduce baseline demand levels without penalty to reflect demand reductions resulting from efficiency improvements verified in the Conservation Improvement Program process.

The contract sets the mill rate to be added to system marginal price at seven mills. The contract runs for five years, until December 31, 2000.

B. Commission Action

The proposed electric service agreement complies with the terms of the tariff rider and is otherwise just and reasonable. It will be approved.

The Commission agrees with the parties that allowing the customer to reduce baseline demand to reflect energy savings from conservation is sound public policy. Failing to reward conservation runs directly counter to longstanding state energy policy. Verifying energy savings through the Conservation Improvement Program is a reasonable precaution to prevent miscalculations.

Allowing either party to adjust baseline demand in the final two years of the contract provides valuable flexibility at low cost. The seven mill rate to be added to system marginal price is reasonable, given the length of the contract and the revenue stream it guarantees.

IV. Conclusion

For all the reasons set forth above, the Commission finds the proposed rider, property transfer, and electric service agreement in the public interest and will approve them.

ORDER

1. The Commission approves the Company's proposed rider to its Large General Service Time-of-Use tariff.

2. The Commission approves the proposed transfer of the Company's Viking North, Donaldson, Plummer, Cass Lake, Cass Lake North, and Clearbrook substations to Lakehead Pipe Line Company, effective January 1, 1996.

3. The Commission approves the proposed electric service agreement between the Company and Lakehead Pipe Line Company.

4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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